No. 17-494

In The Supreme Court of the United States

SOUTH DAKOTA,

Petitioner,

v.

WAYFAIR, INC., OVERSTOCK.COM, INC., AND NEWEGG, INC.,

Respondents.

On Writ Of Certiorari To The Supreme Court Of South Dakota

BRIEF OF FLIPPER LLC, AN AMAZON THIRD PARTY MERCHANT WITH PRODUCT SOLD IN ALL 50 STATES AND OVER 20 COUNTRIES, AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

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INTEREST OF AMICUS CURIAE[1]

Flipper LLC, founded in 2008, is a sole member limited liability company with pass through status. Flipper manufactures and sells Flipper Remote, a high-cost specialty product custom designed for people suffering from Alzheimer's Disease, blindness, brain cancer and any number of other physical and mental challenges.

Flipper's main distribution channel is on the internet, with Amazon.com comprising the majority of Flipper's total sales. Through Amazon's distribution channels, Flipper's product is sold in all 50 states and over 20 countries. But for such internet commerce, Flipper Remote and other specialty products would not exist because big-box retailers do not carry niche items.

Flipper's connection with any state is tenuous at best since it has only one location (the physical location of its owner) and can be operated remotely from any place in the world with an internet connection. Yet, it and other small online businesses like it that rely on Amazon's marketplace to distribute their products are being unfairly and substantially burdened under laws like those in South Dakota and other states. These states accord Amazon special treatment by ignoring its

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[1] Petitioner and Respondents have consented to the filing of this brief in blanket consents that have been lodged with the Clerk. No counsel for a party authored this brief in whole or in part, and no person other than amicus curiae, its members, or its counsel made any monetary contribution intended to fund the preparation or submission of this brief.

own role as the retailer in sales of third-party merchandise and seeking to impose tax collection and notice requirements on remote online merchants even though those merchants have no control over where Amazon stores or sells their products.

While South Dakota supposedly provides a "safe harbor" for small online retailers, Flipper is not protected under that law because small businesses like it are unable to predict how many units they will sell in a given jurisdiction and cannot collect sales tax from buyers retroactively if they meet the sales threshold at the end of the year. And because the tax collection software currently available does not work on Flipper's platform or on many other platforms, these businesses cannot implement a cohesive tax collection solution, and instead must collect everywhere using multiple administrative systems, substantially increasing cost for millions of small businesses.

As a consequence, Flipper and other small businesses that provide products sold by Amazon online have a strong interest in ensuring that any rule adopted by this Court is uniform and does not give rise to a patchwork of discriminatory and unworkable state laws.

SUMMARY OF ARGUMENT

Quill's holding that sales tax for interstate commerce requires a bright line rule because of its peculiarities is truer today than it was in 1992 because

internet commerce is vastly more complicated than the mail order business. Amazon, which did not exist in 1992, now represents more than 40 percent of all internet sales. More than 50 percent of the items sold by Amazon online come from third-party merchants, with small businesses accounting for half of those items. Any change in the applicable standard that does not address Amazon and other marketplace platforms will lead to massive unintended consequences and litigation that will be detrimental to millions of entrepreneurs and consumers.

South Dakota's statute is unworkable and overly simplistic when applied to small third-party merchants. Because they act only as suppliers rather than retailers of merchandise sold to Amazon's customers on its marketplace and Amazon fully controls all aspects of any sale transactions, those businesses cannot be said to have purposefully directed their conduct at the state of South Dakota merely on the basis of Amazon's storage or shipment of merchandise there.

In addition, even if South Dakota could regulate them as a matter of due process, its statute unduly burdens interstate commerce by these and other small businesses. First, they have no way of predicting how many sales will be made in any given jurisdiction and cannot collect sales tax from buyers retroactively if sales there exceed the "safe harbor" threshold at the end of the year. Second, because there is no comprehensive tax software solution that works on all of their platforms, these businesses would need to rely in part upon Amazon's costly tax collection service in

conjunction with other administrative systems to meet their obligations under the statute.

Finally, South Dakota and other states use these laws to discriminate against interstate commerce by third-party merchants in favor of Amazon. Any other large or small retailer in Amazon's position would have been required to register to collect taxes under these circumstances. But while the cost of tax collection for Amazon would be negligible in comparison with the aggregate and substantial cost imposed on small online businesses, Amazon has used its considerable economic power to dictate the circumstances under which it will collect sales taxes.

As a result, South Dakota and other states have discriminated in favor of Amazon and against third-party merchants, threatening these businesses with back-tax liability and penalties if they do not agree to collect taxes, while at the same time forgiving Amazon for its own back taxes. The states' unfair and coercive action confirms that a national sales tax solution, not a patchwork of ill-conceived state laws, is required to address transactions involving marketplace platforms.

ARGUMENT

I. AMAZON'S THIRD-PARTY MERCHANT PROGRAM MUST BE CONSIDERED IN EVALUATING SOUTH DAKOTA'S STATUTE

Amazon did not exist in 1992 when *Quill* was decided. Amazon accounts for an estimated 44 percent of all online sales and third-party merchants generate 51 percent of Amazon's total sales.[2] It is estimated that Amazon has five million third-party merchants.[3] In 2016, Amazon delivered two billion items for third-party merchants.[4] More than half of the items sold by Amazon online come from small businesses.[5] But Amazon is conspicuously missing from the debate in this proceeding. As a result, the Court does not have the record before it needed to get a full understanding of how South Dakota's statute and other state laws that target remote online sales will affect a significant part of the internet retail market and burden interstate commerce.

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[2] *Third-party seller share of Amazon platform 2007-2017*, https://www.statista.com/statistics/259782/third-party-seller-share-of-amazon-platform/.

[3] *Amazon Marketplace: It's Bigger Than It Looks*, Entrepreneur (Oct. 24, 2017), https://www.entrepreneur.com/article/303532.

[4] *Amazon Statistics: Need To Know Numbers about Amazon* (Jan. 24, 2018), https://www.nchannel.com/blog/amazon-statistics/.

[5] *Small business is providing big power behind Amazon* (Dec. 26, 2017), https://www.cnbc.com/2017/12/26/small-business-is-providing-big-power-behind-amazon.html.

A. Amazon Controls All Aspects Of Transactions On Its Marketplace

Amazon has two main selling programs: (1) where it is the "vendor"; and (2) where another business is a "third-party merchant" that uses Amazon's platform. Third-party merchants then choose whether to use Amazon's shipping service, called Fulfillment by Amazon ("FBA"), or ship items themselves. Since millions of customers subscribe to Amazon's Prime Shipping Program, there is a benefit to using Amazon for shipping services via FBA.

Amazon maintains full control over the content of all product listings, including product description, technical details, intellectual property enforcement and the content of customer and seller reviews. Amazon does this to maintain high quality and consistent listings for customer satisfaction. Their goal is to have only one product listing for each specific product.

Each merchant that sells the product is then identified under the main listing. Amazon discloses this information in small print so that customers frequently have no idea whether Amazon or a third-party merchant is the seller of record. If Amazon is designated as the seller, the listing says "Ships and Sold by Amazon.com." If a third-party merchant is designated as the seller and uses FBA, the listing says "Sold by [merchant's name] and Fulfilled by Amazon." And if a third-party merchant is the seller and the shipper, the listing says "Ships and Sold by [merchant's name]."

Since many merchants sell the same product and are listed under the main product listing, Amazon has an algorithm that assigns the "Buy Box." The Buy Box is highly valuable because it controls which merchant is credited with the sale. Very few consumers see who the merchant is or have any relationship with them – Amazon retains full control over this based on their algorithmic factors. The main factors are price, seller performance rating, whether the merchant uses FBA, and whether it is the manufacturer.

FBA is more complicated in practice than it appears to be. Since an estimated 90 million customers subscribe to Prime Shipping,[6] it makes sense for merchants to use FBA. When a merchant sends inventory to Amazon for FBA, Amazon determines the destination "sorting" warehouse for further processing and passes along bulk shipping rates from a preferred common carrier, usually United Parcel Service. At the sorting warehouse, Amazon then determines which "fulfillment warehouse" to send the inventory based on its sales predictions. Amazon strategically places the inventory across the country in fulfillment warehouses to reduce the shipping cost to customers and provide same-day delivery. Amazon has full control over where it sends the inventory; the individual merchant has no control or knowledge of where Amazon places the inventory. Amazon merchants only find out about a sale

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[6] *Here's How Much Amazon Prime Members Spend Per Year*, Fortune (Oct. 18, 2017), http://fortune.com/2017/10/18/amazon-prime-customer-spending/.

after it occurs, and even then, only if they download specified reports.

There is a quirk of using FBA. Since each product needs to be identified, it requires either the Universal Product Code ("UPC") label or an Amazon FBA label with a unique identifier. Amazon provides a labelling service for an extra cost, or else merchants can use the product's UPC label. If merchants decide to use the UPC, Amazon categorizes this inventory as "commingled." Commingled inventory can be attributed to any merchant that uses the UPC label for identification purposes.

For example: Merchant A sends goods to a sorting warehouse in Pennsylvania and Amazon disperses this to five warehouses in the eastern U.S. Merchant B sends the same product using the UPC label to a fulfillment warehouse located in Colorado. If Amazon's Buy Box algorithm attributes a sale to Merchant A for a customer located in South Dakota, Amazon may pick and ship from Merchant B's inventory located in Colorado because it is the closest. Merchant A then gets credited for the sale to a customer located in South Dakota even though it had no physical control over the product that was sourced from Colorado, and no physical product was ever stored in South Dakota. Under South Dakota's law, Merchant A is responsible for collecting and remitting sales tax even though it never "owned" or had physical control of the actual item sold.

B. Under Existing Laws In Every State, Amazon Should Be The Sole Party Responsible For Collecting Any Sales Tax Due On Sales Of Products Supplied By Third-Party Merchants

As one state (South Carolina) has recognized in pursuing back taxes from Amazon on marketplace sales of third-party merchandise, under tax laws already in place in every state, Amazon rather than the third-party merchant is the actual retailer in FBA sales and as such should be solely responsible for collecting any sales tax due on those sales.[7]

Amazon has argued that FBA merchants are selling directly to the Amazon customer and consequently the onus is on the merchants to collect and remit sales tax. But based on Amazon's role in the transactions, South Carolina considers the third-party merchants to be suppliers and/or consignors of merchandise and it has therefore concluded that the sales are to Amazon's customers rather than to the third-party's customers. As that state has noted, Amazon handles all of the storing, packaging and shipping of property held in fulfillment centers and controls which fulfillment centers are used for the storage of products. Amazon controls to whom and to where the merchandise is sent and effects the actual transfer of the property to its customers. Amazon accepts payment for that merchandise

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[7] *South Carolina DOR Goes After Amazon Services For Unreported Sales/Use Tax On Third-Party Transactions*, https://www.brannlaw.com/eyes-on-ecom-law/south-carolina-dor-goes-amazon-services-unreported-salesuse-tax-third-party-transactions/.

and holds the funds, receiving a commission for the sale. Amazon also makes it clear that it owns the customer in all cases. Vendors and third-party merchants cannot contact Amazon's customers unless the communication specifically relates to delivery of their order and uses Amazon's communication system.

As South Carolina has reasoned, the FBA process is less akin to drop shipping, and more like selling based on consignment. In consignment sales, the seller is required to comply with the tax collection, not the provider. In the case of both a consignment shop and FBA, the shop owner (or Amazon) houses the inventory, delivers it to the customer, deducts a commission and other fees from the sale and pays the vendor. Amazon's FBA merchants are not the same as retailers at a mall or farmer's market, nor is selling on Amazon's marketplace like selling to customers on Craig's List. These merchants are prohibited under Amazon's Terms and Conditions from contacting customers with sale offers. Customers pay Amazon, and Amazon controls refunds.

Accordingly, under background laws applicable to every other retailer, Amazon should be the one responsible for collecting and remitting sales tax in states where the inventory is warehoused, just as the consignment shop has to collect and remit sales tax where the shop is located. This approach is manifestly correct because Amazon is the same as a large retailer like Target or Best Buy. Those other large retailers do not get special treatment. There is no agreement that Target can execute with one of its product suppliers that

would allow Target to avoid its responsibilities on collecting taxes on sales of that product at Target. Target could not simply shift its existing legal obligations by claiming to now be the "Target marketplace" in its South Dakota stores and telling Apple that Target no longer wants to take title to Apple's inventory in those stores, that Target now merely provides a marketplace service for Apple via its store locations, and that Apple will therefore be the contractual merchant of record on sales of Apple products even though Target's level of control over the transactions and customer relationship is unchanged.

Neither South Dakota nor any other state would ever allow Target or any other large or small physical retailer to get away with this, yet that is exactly what Amazon has (successfully) sought to do in asserting that it is not responsible for collecting sales tax and that third-party merchants are the retailers because Amazon has contractually designated them as the seller of record on marketplace sales.

II. SOUTH DAKOTA'S STATUTE IS UNWORKABLE AND DISCRIMINATORY IN ITS APPROACH TO SMALL BUSINESSES WHOSE PRODUCTS ARE SOLD ONLINE BY AMAZON

A. South Dakota's Law Violates The Due Process Rights Of Amazon's Third-Party Merchants

Given the way in which Amazon sales of third-party merchandise are conducted, the Due Process Clause would not allow South Dakota to assert a tax nexus over third-party sellers for their role in these sales. As this Court recognized in *Quill*, a business must "purposefully avail itself of the benefits of a [state's] economic market" for the business to be subject to the state's taxing authority. *See Quill Corp. v. North Dakota*, 504 U.S. 298, 308 (1992).

Here, because Amazon's third-party merchants merely sell or supply their products to Amazon but have no control over where that merchandise is stored or shipped – and Amazon does not even have a physical presence in South Dakota – those merchants cannot be said to have purposefully directed their business activity at the South Dakota market even if those merchants have reason to know that their products might eventually reach consumers in that jurisdiction. *See Asahi Metal Indus. Co. v. Superior Court*, 480 U.S. 102, 110 (1987) (concluding that the mere fact that a supplier introduces a product into the stream of commerce is not alone sufficient to establish personal jurisdiction there); *J. McIntyre Mach., Ltd. v. Nicastro*, 564 U.S. 873,

886-87 (2011) (holding that even where there is "an intent to serve the U.S. market," due process requires "purposeful availment of the [state's] market" to subject a business to jurisdiction there).

B. South Dakota's Law Substantially And Unduly Burdens Interstate Commerce Of Small Online Businesses

Even if third-party merchants could be said to purposefully avail themselves of the South Dakota market for due process purposes so as to support the state's assertion of tax collection authority, the law imposes unnecessary and undue burdens on small businesses.

First, the "safe harbor" for small online retailers offers no real protection for these businesses. South Dakota's statute states that it only applies if gross sales exceed $100,000 or there are 200 specific transactions in the State during the year. However, small businesses and startups cannot predict how many transactions will happen during the year in any given state or local jurisdiction. As a result, they have no meaningful choice but to register to collect and remit sales tax in every jurisdiction. The 200th sale may not occur until December 31st, and since many online products cost as little as one cent,[8] gross sales of $2 will trigger liability on December 31st. Yet, because sales tax cannot be collected from buyers retroactively, small businesses must as a practical matter collect at the

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[8] *One Cent Items*, Amazon, https://www.amazon.com/slp/1-cent-items/gb3sywbtdwrz8da.

beginning of the year in order to avoid subsequent liability if they meet the threshold for tax collection.

Second, there is no comprehensive tax software solution that works on every internet platform in real time. Many sites use custom designed platforms and carts that are not supported by any tax software. For example, Squarespace, which is used by Flipper, does not work with any software, yet Squarespace powers millions of websites.[9] Other major sites are not compatible with the Certified Software Providers, including Wix.[10] Still other sites do not have any mechanism to collect sales tax, including Indiegogo, Kickstarter, Pinterest, Upwork and an unknown number of others. Small business will need to use multiple administrative systems in order to comply with many different jurisdictions, costing hundreds of millions to implement and increasing the risk of inadvertent error. While Amazon offers a tax collection service, this involves an additional 2.9 percent fee that is significant for many third-party merchants and provides Amazon with another profit center that will result in billions of extra dollars in revenue.

Since Amazon already collects on its own sales, it could start collecting tomorrow for all merchants at negligible cost. In fact, in Washington and Pennsylvania –

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[9] *Customers*, Squarespace, https://www.squarespace.com/customers.

[10] *Wix.com Surpasses 100 Million Registered Users Milestone* (Feb. 15, 2017), https://investors.wix.com/investor-relations/press-releases/press-release-details/2017/Wixcom-Surpasses-100-Million-Registered-Users-Milestone/default.aspx.

the states where Amazon is headquartered and where it has the largest number of warehouses in this country, respectively[11] – Amazon has already agreed to collect and remit sales tax on marketplace sales of third-party merchandise through its new Marketplace Tax Collection service.[12] By contrast, the costs of collecting these taxes would be prohibitive for merchants like Flipper that sell specialty items.

To illustrate the issue more concretely, let's say that out of the five million estimated third-party merchants, one million generate enough sales to be concerned about sales tax liability. Certified Software Provider Avalara charges $3,000 to file sales tax returns in numerous jurisdictions.[13] The aggregate cost to small business is three billion dollars, not including professional and site redesign fees. Net profit margins are already small for niche products like Flipper Remote, so forcing these additional costs will put many out of business. This is actually not in Amazon's best interest because customers go to Amazon to find products that are not available in retail stores.

While these burdens are created by South Dakota's statute, that law is only one approach to the

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[11] *Amazon Fulfillment Center Locations*, https://www1.avalara.com/trustfile/en/resources/amazon-warehouse-locations.html.

[12] *Amazon to Collect Tax in Pennsylvania: What do eCommerce businesses need to know?* (May 9, 2018), https://taxify.co/2018/03/09/amazon-collect-tax-pennsylvania-ecommerce-businesses-need-know/.

[13] *TrustFile Pricing*, Avalara, http://www1.avalara.com/trustfile/en/pricing.html.

sales and use tax that has been adopted by the states to address online sales. Various models include Colorado's reporting law, New York's click-through nexus law, Virginia's storage-of-inventory nexus law and South Dakota's economic nexus law. This patchwork of laws in itself burdens interstate commerce because small businesses will be forced to navigate a complex legal framework that will detract from product development and substantially reduce their revenues. Moreover, Amazon's platform presents specific challenges in various states because individual merchants cannot control Amazon and therefore have no way of complying with states that have customer notice requirements like Colorado.

These heavy burdens on interstate commerce by small businesses could be eliminated by placing a minimal burden on Amazon (or other marketplace sellers) under existing tax law in South Dakota and other states. However, as further discussed below, most states are unwilling to subject Amazon to such laws out of fear of losing business from that company, and they choose instead to look to small third-party merchants to fulfill Amazon's own tax collection obligation.

C. South Dakota Uses Its Law To Impermissibly Discriminate In Favor Of Amazon And Against Third-Party Merchants

Currently, Amazon only collects and remits sales tax where it deems itself the vendor and not where it

deems the sale from a third-party merchant.[14] However, as the above facts show, the distinction is illusory: Amazon controls all aspects of the sales process and any other company would be treated as the retailer in marketplace transactions. The cost for sites like Amazon to collect and remit sales tax on all its sales is negligible; for small business, and states to administer against small businesses, cumulatively, the costs are astronomical. Yet, because of Amazon's economic power, South Dakota and other states choose to ignore the facts and accept Amazon's assertion that it merely facilitates transactions in which others are retailers. In essence, these states have allowed Amazon to tell them when it can be legally responsible for collecting sales taxes.

Previously, Amazon refused to concede that even its own warehouses constituted a physical presence. As Amazon began rapidly expanding its fulfillment network to provide faster delivery to consumers, it began to change its position, and was able to use sales tax as a negotiating point when it came to building out its network. For instance, when Texas presented Amazon with a $269 million tax demand in 2011, Amazon closed its one Texas fulfillment center and cancelled plans for another it had in the state.[15] Texas eventually capitulated to Amazon's demands and forgave all back

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[14] *Amazon Sellers Brood as States Come Calling for Taxes* (Nov. 11, 2017), https://www.nytimes.com/2017/11/15/technology/amazon-sales-tax.html.

[15] *Amazon's (not so secret) war on taxes* (May 23, 2013), http://fortune.com/2013/05/23/amazons-not-so-secret-war-on-taxes/.

taxes, and now pays a sales tax incentive to Amazon for opening a distribution center.[16]

Amazon changed course last year and agreed to collect taxes on "vendor" transactions in all states that have a sales tax.[17] Not long after, Amazon announced a competition for states to compete to provide massive subsidies for its new headquarters.[18] Amazon is currently seeking an additional $5-7 billion in tax subsidies from the states in addition to the estimated more than $1 billion that it has already received.[19] In fact, there is evidence that other countries are similarly according Amazon special treatment under their own sales tax laws out of concern that Amazon might not build warehouses there if it is required to comply.[20]

No small out-of-state business has the benefit of Amazon's economic might. Small third-party merchants

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[16] *Tax incentives get Amazon to build fulfillment center in Katy* (Mar. 29, 2017), https://www.houstonchronicle.com/business/retail/article/Tax-incentives-get-Amazon-to-build-fulfillment-11037679.php.

[17] *Amazon to start collecting state sales taxes everywhere* (Mar. 29, 2017), http://money.cnn.com/2017/03/29/technology/amazon-sales-tax/index.html.

[18] *Amazon to add second headquarters with up to 50,000 jobs in grab for talent* (Sept. 7, 2017), https://www.usatoday.com/story/money/2017/09/07/amazon-plans-second-headquarters-dubbed-hq-2/640861001/.

[19] *Is Amazon Too Big to Tax* (Mar. 1, 2018), https://newrepublic.com/article/147249/amazon-big-tax.

[20] *Secret recording suggests HMRC told to go easy on Amazon* (Jan. 24, 2018), https://economia.icaew.com/en/news/january-2018/secret-recording-suggests-hmrc-told-to-go-easy-on-amazon.

are subject to enforcement actions that include back taxes, interest and penalties. Unlike Amazon, these businesses cannot stand up to the various states, especially since facing an enforcement action in multiple state and local jurisdictions simultaneously is exceedingly complicated and expensive. Small businesses like Flipper have no choice but to pay, and if facing past tax from multiple jurisdictions, they may well go out of business.

The conduct of the Multistate Tax Commission ("MTC") in which South Dakota and many other states participate further illustrates the coercive nature of state tax collections with respect to third-party merchants and what these merchants will face if the South Dakota law is upheld. The MTC offered an "amnesty" program[21] last fall (conspicuously timed with Amazon's launch of its headquarters contest) that threatened these merchants with the potential for massive back taxes and penalties unless they started to collect taxes.[22] By contrast, Amazon has never paid any back taxes or penalties and, as previously noted, only South Carolina is currently seeking back taxes from Amazon for sales of third-party merchant items through marketplace.

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[21] *States offer sales tax amnesty program for marketplace sellers* (Aug. 16, 2017), https://www.digitalcommerce360.com/2017/08/16/sales-tax-amnesty-program-marketplace-sellers/.

[22] *States vs. Marketplace vs. Third-Party Sellers – The Amazon Sales Tax Challenge*, https://www.bna.com/states-vs-marketplace-n73014464175/.

The argument made by both MTC and the Certified Software Providers at the time was that because these merchants have inventory in an Amazon warehouse, this "almost certainly" constitutes physical presence and consequently they had better register and collect or face potential liability for back sales tax, penalties and interest,[23] even though no court has ever adopted this position and it conflicts with basic due process principles insofar as FBA merchants have no control over where Amazon stores their inventory. The MTC's approach is particularly problematic because with so many different rules and the inability to retroactively collect sales taxes, small third-party merchants would have no choice but to collect and remit those taxes in every jurisdiction where Amazon might store and/or ship their merchandise.

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[23] *Amazon Sellers Brood as States Come Calling for Taxes*, *supra* n. 11; *Guide to Sales Tax Collection in Amazon*, https://www1.avalara.com/trustfile/en/guides/amazon/sales-tax.html.

CONCLUSION

Whether or not *Quill*'s bright line rule needs to be updated, the issues presented by Amazon marketplace sales cannot be addressed by a patchwork of discriminatory and unworkable state laws. Instead, a national sales tax framework is needed that properly accounts for marketplace platforms.

Respectfully submitted,

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